U.S. Virgin Islands. This is because the model was developed for larger carriers, who tend to provide a large number of lines in different areas with differing terrain features. As a result, if the model does not accurately reflect the terrain of a given, specific location, it is likely that there are other locations with different characteristics within the carrier's service area that would serve to counterbalance this inaccuracy. In other words, expensive costs in one area would be ameliorated by cheaper costs in another. However, as indicated previously, the terrain in the U.S. Virgin Islands is uniformly characterized by the presence of unique terrain features (such as bodies of water and mountains) that are not considered in the model.

In fact, the Commission has acknowledged that the use of national averaging can produce inaccurate results. The Commission has noted that "varying plant mix [in the forward looking model] by state, study area, or region of the country may more accurately reflect variations in forward-looking costs" and that it "intend[s] to seek further comment on this issue."[52] However, the Commission concluded in the non-rural proceeding that attempting to solicit and verify cost data from all of the local exchange carriers in the country would be administratively burdensome and unmanageable, and that any gain in accuracy over the model that they adopted was not worth the substantial time and expense.[53] The Commission could reach this conclusion because the larger carrier would face enough of mix of terrain so that any inaccuracies would come out in the wash.

However, Vitelco enjoys no such luxuries. The very small size of the U.S. Virgin Islands telephone market (less than 61,000 lines) means that a carrier operating in the U.S. Virgin Islands

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[52] *Federal-State Joint Board on Universal Service; Forward Looking Mechanism for High Cost Support for Non-Rural LECs*, 14 FCC Rcd 20156, 20199 (1999) (Tenth Report and Order) ("*Input Order*").

will have no opportunity to take advantage of averaging.[54] The entire, small community that Vitelco must serve is located on land that has radically higher network construction and maintenance costs than the average assumptions that the model makes. Of course, this means that the actual cost of providing service in the U.S. Virgin Islands will, overall, be much higher than the model predicts.

In addition, the way in which the model predicts customer locations may prejudice the Virgin Islands. For regions where there is no available data on actual customer locations (like the Virgin Islands), the FLEC model must employ other methods to assign customer locations. As Dr. Gordon explains, the model "estimates costs by distributing customers throughout an area using a theoretical construct in the absence of geocoded data. Since the U.S. Virgin Islands are separated by water, the absurd end result of applying the Commission's model could be to 'place' customers in the bodies of water separating the islands and thereby underestimate the real cost of providing service."[55]

Further, the model does not attempt to adjust cost figures for the kind of pronounced elevation changes that can be seen in the U.S. Virgin Islands. For instance, elevations on St. Thomas range from zero to 1600 feet above sea level, with very little flat space in between. While the model may be able to produce an accurate measure of the cost of provisioning service over flat or mildly rugged terrain, it is impossible for a nationally generalized model, created to

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53 *See id.*

54 The number of local loops in the U.S. Virgin Islands in 1997 was 63,234. *See* Indus. Analysis Div., Common Carrier Bureau., FCC, *Trends in Telephone Service*, at 20-4 (Mar. 2000).

55 Gordon Comments at 20 (footnote omitted).

reflect average terrain values, to produce a realistic picture of service costs in an area with terrain as mountainous as St. Thomas.

C. An Advanced-Service-Capable Network in Insular Areas Is Only Possible Through an Actual Cost-Based Support Calculation.

Although the Commission's hypothetical FLEC model attempts to determine the appropriate level of universal service support necessary to enable the provision of advanced services, this aspect of the model too would result in underfunding of insular carriers. The model makes various assumptions about which technologies would be the most efficient or "best cost" to use in a given area, based on factors such as loop length and population density.[56] These assumptions are based on choices optimized for conditions on the *mainland*, and do not reflect the constraints that insular carriers face in selecting, constructing and maintaining a telecommunications infrastructure suited to their unique situation. Because of the geography, weather, and population characteristics of insular regions, a carrier that wishes to provide service to the residents of such an area must use a very different cost-benefit analysis in network design than a carrier providing service on the mainland. Storm durability and resistance to heat and corrosion are two examples of factors that must be weighted more heavily in insular areas than the model does in making predictions for mainland carriers.

Similarly, the fact that insular regions are surrounded and often bisected by large bodies of water means that a predicted loop cost based on the use of land-lines will likely anticipate using an improper or non-optimal technology. And even if the model does select the correct technology, the cost attributed to construction and maintenance of a land-line will be far lower than those for a similar technology used in a marine environment. As a result of these two

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56 *See Input Order*, 14 FCC Rcd at 20187.

factors, the model will likely yield a very conservative estimate for the costs of implementing inter-island links.

The Commission has said that it will initiate another proceeding to study how the forward looking model should be used in the future, how the inputs should be changed to reflect new technologies, and how often the Commission should update these inputs.[57] This future proceeding illustrates another danger of trying to apply a national forward looking model to insular carriers. Currently, the model has a variety of flaws that will prevent it from producing an accurate cost prediction in the insular setting. As technology evolves, these flaws are not likely to decrease in importance. The structure of the model, which bases cost estimates on national averages, is fundamentally at odds with accurately predicting costs in an extremely unique environment such as an insular region. Each new technology that the Commission adds to the model's structure will share this basic flaw.

It is safe to assume that none of these new technologies will cost *less* to implement in an insular market than they do, on average, on the mainland. However, without knowing what these technologies are, what kind of cost structures they might have, or how the model will eventually evolve to incorporate them, it is impossible to say with any certainty how serious the cost underfunding will be. The FCC should not use a model that will have a certain negative impact of an unknown degree on the future development of technology in insular markets.

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57 *Input Order*, 14 FCC Rcd at 20170.

V. THE FCC'S FLEC COST MODEL AND THE NON-RURAL CARRIER UNIVERSAL SERVICE MECHANISM WILL NOT SUFFICIENTLY SUPPORT UNIVERSAL SERVICE IN INSULAR AREAS.

The RTF's conclusion that "the non-rural method and Synthesis Model developed for the non-Rural Carriers are not the appropriate tool and application for Rural Carriers"[58] is clearly correct. For one, the Commission's model has not been shown to be reliable for areas with unique geography, such as that found in the U.S. Virgin Islands. Moreover, use of Forward Looking Economic Costs ("FLEC") will not adequately compensate rural and insular companies for the costs of providing service to their subscribers. Thus, in the end, the use of the methods and models developed for non-rural carriers in the insular and rural carrier context will, as the RTF explained, "not produce a sufficient universal service mechanism for Rural Carriers that is in the public interest and consistent with the principles of the 1996 Act."[59]

A. The Commission's Model Has Not Been Shown To Be Reliable For Areas With Unique Geography

As the RTF documented in *The Rural Difference*, the areas served by insular and rural carriers are very different from those areas served by non-rural carriers.[60] Therefore, "a 'one-size-fits-all' national universal service policy is unlikely to be successful in fulfilling the national universal service principles contained in the 1996 Act."[61] A corollary of this conclusion is that the cost model developed for non-rural carriers will not be universally applicable, especially for territories such as the U.S. Virgin Islands. As discussed above, a number of unique factors make the application of a FLEC model particularly inappropriate for the U.S. Virgin Islands.

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58 *RTF Recommendation* at 20.

59 *Id.*

60 *See generally, The Rural Difference.*

61 *RTF Recommendation* at 14.

Moreover, there is no evidence that the Commission's FLEC-based non-rural carrier model would be reliable when applied to insular areas. In fact, when applying the model and its inputs to derive the costs faced by insular carriers, the Commission's non-rural model is a completely unknown quantity. The Commission itself has not tested the model using data from the U.S. Virgin Islands.[62] Even the RTF, when it ran a study using rural data, did not employ a broad base of insular areas data because such data were unavailable.[63] Therefore, simply to ask the Commission to adopt its non-rural model as the appropriate model for insular areas would represent an arbitrary decision fraught with uncertainty that is lacking any evidentiary support at all.

B. FLEC Will Not Adequately Compensate Insular Companies for the Actual Costs of Providing Service.

The use of a FLEC model using the hypothetical network will not generate results that will adequately compensate insular and rural carriers for the costs they actually must incur to provide service to their customers in their operating areas. The FLEC based model, because it fails to deal with the realities of the unique characteristics of insular areas, fails to provide sufficient support for universal service in those markets.

By its nature, a FLEC model deals only in the hypothetical, not actual, world. This is the essence of such a model. Such models simply fail to "deal[] with reality."[64] Instead, a FLEC

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62 *See Federal-State Joint Board on Universal Service, Access Charge Reform,* 14 FCC Rcd 8078, 8092-94 (1999).

63 *See* Rural Task Force, *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies; White Paper No. 4*, at 5 n.3 (Sept. 2000), *available at* <http://www.wutc.wa.gov/rtf> ("*RTF Model Study*") (noting that "due to data limitations it was not possible to run the model for some Rural Carriers, particularly those in Alaska and the insular areas"); *see also id.* at 22.

64 *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 750 (8th Cir. 2000).

model, in the words of one court, "fantasiz[es] about what might be."[65] The RTF's study of the application of the FLEC-based, non-rural model in the rural context demonstrated that the FLEC model failed the rural and insular reality check. In that analysis, the RTF found that the application of the FCC's model would result in a *$1.102 billion decrease* in funding.[66] This represents a *70% decrease* from the current level of support. Compare this result with that of the non-rural carriers. There, the *RTF Model Study* found that the application of the FCC's model differed from current levels of funding by only $34 million dollars. Thus, it is clear from the data that the non-rural carrier model would most certainly result in the serious underfunding of the insular and rural carrier universal service support.

Section 254 is concerned with the realities of high cost service. This section specifically requires support to be "sufficient" to cover the costs of carriers requesting support.[67] The purpose of the high cost support program is "to enable access to telecommunications service in areas where the cost of such service otherwise would be prohibitively high."[68] It is clear, however, that reducing support by over 70% flies in the face of the reality required by Section 254. The only option is to not use of a FLEC-based model in rural and insular areas.

C. Use Of The National Benchmark Established For Non-Rural Carriers Will Seriously Underfund Universal Service For Rural Carriers.

The results of the *RTF Model Study* also illustrate the fact that the use of the non-rural national benchmark will seriously underfund the required universal service support for rural carriers. Under the model for non-rural carriers, the federal fund provides support to states where

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65 *Id.*

66 *See RTF Model Study* at 7.

67 47 U.S.C. § 254.

the statewide average exceeds 135% of the nationwide average forward-looking cost. When this figure is used to calculate the size of the total universal service fund (rural and non-rural), the amount of universal service support available to all carriers falls by over $1 billion (from $1.76 billion).[69] The problem, as identified by the RTF, is that, because the number of lines served by rural carriers is so small, their higher costs to provide service get washed out when a statewide average is used.[70] So, while the average cost of a rural carrier to provide a line to a customer is over $35 more than the non-rural carrier's cost, the addition of these costs only increases the national average by $2.57.[71] Thus, it is clear that simply folding in rural carriers into the non-rural nationwide benchmark will fail to account for these statistical anomalies. In the end, using the non-rural national benchmark will not provide sufficient universal service support to rural carriers.

D. The FCC Cannot Necessarily Look to Intrastate Funding To Replace Lost Support Because There May Be No Viable Sources Available.

In insular markets, many of which continue to experience depressed economic conditions, there is simply less room for error when it comes to establishing costs for the provision of telecommunications services. This is because islands tend to have a precarious economic position at the outset. As discussed above, insular markets like the U.S. Virgin Islands are characterized by single-industry, service based economies, high unemployment, low annual incomes, and very high costs of living that stem from the need to import nearly everything from heavy equipment to, in some cases, drinking water. Even when everything is functioning

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68 *Ninth Report & Order*, 14 FCC Rcd at 20439.

69 *See RTF Model Study* at 18.

70 *See id.* at 17.

perfectly, these economies present a very difficult environment for the establishment and maintenance of a high fixed-cost industry such as telecommunications. The ability of insular carriers to make a reasonable return on investment is thus nearly always in question.

Another problem unique to insular areas concerns the characteristic of traffic and the ability of the state/territorial commission to generate funding. In the U.S. Virgin Islands, the entire territory is one local calling area.[72] As a result, *no intrastate toll service exists in the territory to allow the territorial Commission to generate additional funding to subsidize high-cost local service.* Without this alternative source of funding, the only source of funds available to the territorial Commission to offset a reduction in the federal contribution is to raise the rates of the telephone subscribers of the Territory. However, the territorial Commission's ability to increase rates is further limited (in addition to the Islands' economic conditions) by the small customer base of approximately 60,000 local loops. This means that any required cost increase cannot be widely dispersed. Any increase would hit every ratepayer hard.

Finally, any support mechanism must account for the fact that, in some areas such as the U.S. Virgin Islands, any additional local funding of universal service would come from the very same people who receive it. The small customer base and the lack of intrastate toll means that each dollar of reduced federal funding would result in a dollar of rate increases. Even if only business rates are raised, given the insular nature of the territory and the non-export nature of the economic base, customers on the Islands would pay for any increase. In essence, the citizens of the U.S. Virgin Islands would be robbing Peter to pay Paul. This effect must be considered when

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71 *See id.*

72 Of note, the RTF rural study found that the bulk of the traffic carried in rural areas is not local. *See The Rural Difference* at 41-44. In the case of the VIPSC, that would suggest that the

the Joint Board makes its recommendation to the Commission on a rural carrier support mechanism.

In the end, any errors resulting from the application of a hypothetical model would obviously have a dramatic, negative impact on insular regions, particularly the U.S. Virgin Islands. By underestimating the cost of providing service, and thus underfunding these carriers, the Commission would be asking what are already some of the poorest regions of the United States to tighten their belts in order to make up for an error in regulation. While a large, urban carrier might be able to shrug off a moderate costing mistake by passing a relatively small increase along to a large customer base with a commensurately large and solid economy, an insular carrier's small size means that the individual rate increases would be much larger, and that these larger increases would have to be supported by an economy that is already quite delicate and in poor health. Requiring struggling insular economies to support the relatively large drain that could come from the imperfect application of the FLEC model cannot be what Congress intended when it mandated that insular regions receive a level of service similar to that enjoyed by larger markets.

VI. LONG TERM SUPPORT MUST REMAIN PART OF THE HIGH COST FUND CALCULATION IN ORDER TO MAINTAIN SUFFICIENT UNIVERSAL SERVICE SUPPORT.

Vitelco supports the RTF's recommendation to retain the existing Long Term Support ("LTS") mechanism for rural carriers remaining in the National Exchange Carrier Association ("NECA") Pool. The LTS mechanism currently comprises an important part of the total support given to insular carriers. In 1999, Vitelco received $7,133,280 in LTS, a substantial portion of

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bulk of traffic would be beyond its jurisdictional reach.

Vitelco's universal service support. It is these LTS payments that allow Vitelco and other high cost LECs to be able to charge lower per minute access charges to its interexchange carriers.[73]

The FCC itself recognized the importance of LTS to the overall universal service mechanism when it said:

> [W]e agree with the Joint Board that *LTS payments serve the public interest* by reducing the amount of loop cost that high cost LECs must recover from IXCs through CCL charges and thereby facilitating interexchange service in high cost areas *consistent with the express goals of section 254*. Thus, although we remove the LTS system from the access charge regime, *we adopt the Joint Board's recommendation that we enable rural LECs to continue to receive payments comparable to LTS from the new universal service mechanism*.[74]

The stark fact is that Vitelco and other insular carriers depend upon LTS to maintain rates at reasonable levels. As discussed above, even with the existing level of LTS, Vitelco's local rates are somewhat higher than the average rates for other rural and urban carriers. If the Commission were to chose not to continue to allow insular carriers to obtain the current level of LTS, Vitelco would be faced with increasing its interstate access charges in order to recover the allocated interstate loop costs. Such a rate increase would certainly undermine the goals contained in Section 254. Another possibility could be developed such that the territorial commission could recover the universal service shortfall from other regulated entities. This, however, would result in an untenable situation.

As noted above, in the case of the U.S. Virgin Islands, no real alternative would exist. The Virgin Islands Public Service Commission ("VIPSC") would have no adequate alternative

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[73] LTS reduces the per minute Carrier Common Line ("CCL") access charges of the rural LECs. However, the per minute CCL access charges of larger Price Cap LECs is substantially lower and in some instances non existent.

[74] *Universal Service Order*, 12 FCC Rcd at 9165 (emphasis added).

source of funding available to meet the LTS (and high-cost fund) shortfall. Without an alternative source of funding, the only source of funds available to the VIPSC to offset elimination of the LTS would be to allow consumers' telephone rates to rise. Of course, any rate increase would increase the disparity that already exists between the rates available to consumers in insular areas and the mainland. This would inevitably thwart any progress in increasing the telephone penetration rate for insular areas. For the U.S. Virgin Islands, the abandonment of LTS would prevent the penetration rate from closing the gap with the U.S. national average, and may even cause it to decline from existing levels.

For these reasons, the Commission should continue LTS for rate of return insular carriers, regardless of the what policy it decides to adopt for the non-rural carriers.

VII. THE JOINT BOARD MUST REFORM THE ARBITRARY LIMITS ON UNIVERSAL SERVICE FUNDING.

The Joint Board has a statutory obligation to recommend the elimination or reform of the policies that arbitrarily limit the size of the universal service fund or restrict the ability of insular and rural carriers to recover the costs of providing service. The statutory mandate of Section 254 is clear – the amount of support must be "sufficient ... to preserve and advance universal service."[75] Vitelco supports the compromise reached by the RTF to create a modified embedded cost mechanism because such a mechanism will do a better job of protecting universal service in insular areas than the current system.

First, the recommended modifications to the overall cap are at minimum an essential ingredient to satisfying this statutory mandate in high cost, rural and insular areas. The

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[75] 47 U.S.C. § 254(b)(5).

arbitrariness found in the establishment of other caps and restrictions must go. Second, the recommendations concerning mergers and acquisitions by the RTF go far in eliminating the counter productive aspects of the existing rule. Third, with respect to the special needs and circumstances of insular and rural areas, the limitations on corporate operations expenses is an arbitrary policy that must be changed. Again, the recommendations of the RTF do much to reform this rule in a positive manner. Finally, while the RTF failed to address the issue of stranded costs, this issues must be examined. As discussed above, it is essential that carriers have the ability to recover actual costs that they incur to provide service. Therefore, it is important that insular and rural carriers have an ability to recover those stranded costs as well.

A. The RTF's Response to the Current Universal Service Cap Represents A Reasonable Policy Balance.

Vitelco supports the RTF's recommendation that the existing cap on the overall size of the high cost fund be significantly modified.[76] The basis of the existing cap is not supported by the requirements of the 1996 Act. Rather, the Commission first adopted a mechanism to cap the growth of available high cost funds in 1993[77] in response to its concerns over the growth of

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[76] *RTF Recommendation* at 24. In fact, Vitelco believes that complete elimination of all artificial caps is necessary to provide sufficient support for insular and rural companies. Nevertheless, Vitelco is willing to support the modified caps as proposed in the context of the RTF's overall recommendations, including ensuring that a FLEC model would not be used in the rural and insular context, that such carriers would receive different treatment, and that other caps would be reformed.

[77] *See Amendment of Part 36 of The Commission's Rules And Establishment of a Joint Board*, 9 FCC Rcd 303 (1993) (*"Interim Cap Order"*). The Commission then extended these interim rules through July 1, 1996. *Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, 11 FCC Rcd 2538 (1995) (Report and Order). The Joint Board recommended, and the Commission adopted, an extension of the interim cap until final universal service rules become effective. *Federal-State Joint Board on Universal Service,* 11 FCC Rcd 7928 (1996) (Recommended Decision); *Federal-State Joint Board on Universal Service*, 11 FCC Rcd 7920 (1996) (Report and Order).

universal service support and to hold that growth to moderate levels.[78] Nowhere does Section 254 expressly permit such a rationale to be used in formulating the universal service support equation in insular and rural areas served by rural carriers. Vitelco submits that under the existing caps, the Commission cannot satisfy its statutory mandate to provide sufficient support.

Nevertheless, while a policy completely eliminating arbitrary caps represents an ideal world, Vitelco recognizes that fund caps may be an inevitable policy compromise. Caps represent the balancing of the various interests of those parties affected by the payment and receipt of universal service funds. To achieve this balance in a rational way, Vitelco supports the RTF recommendation to resize the fund in a reasonable manner and then adjust the size of the fund by the rural growth factor. Additionally, the use of the RTF's equation to adjust the level of the cap provides a level of predictability that is not provided under the existing cap mechanism. Such an approach would make fund receipts sufficient and more predictable, in a manner that is more consistent with Section 254.

B. Restricting Support on Lines Obtained by Merger and Acquisitions Is Shortsighted and Contrary to the Public Interest.

Limiting the support a carrier can receive on lines it obtains through merger and other types of acquisitions is bad public policy and contrary to Section 254's mandate. For one, there is a concern that this restriction arbitrarily prevents carriers from obtaining sufficient support. The rule was adopted by the Commission as a "stopgap measure" to address a specific problem at a certain point in time.[79] However, "by freezing support based on the seller's embedded costs, the rule prevents the acquiring carrier from receiving an amount of support related to the costs of

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78 *Interim Cap Order*, 9 FCC Rcd at 303.

79 *Federal-State Joint Board on Universal Service*, CC Docket 96-45, FCC 00-J01, at ¶ 20

providing supported services in the transferred exchange."[80] The existing arbitrary restriction is counter to the funding requirements of the Act. The policy also fails to adequately acknowledge that the acquiring carrier may be in a better position to provide higher quality and advanced services in that service territory.

Section 254 requires that all Americans, including those in rural and insular areas, enjoy "[q]uality services"[81] and "have access to ... advanced telecommunications" and information services.[82] The merger and acquisition cap puts the achievement of these statutory requirements in jeopardy. The RTF notes that Section 54.305 of the Commission's Rules "limits the ability and motivation of the acquiring entity to make new investments to upgrade the networks" of acquired properties.[83] Such an approach, essentially "doom[s]" customers in high cost rural exchanges involved in sales/transfers to poor service[84] and hinders the ability of carriers to roll out advanced services. In short, such a policy is very shortsighted and is not in the overall public interest. Even the Commission itself has noted that a significant public interest benefit to the merger/transfer of rural exchanges is that the new company is willing to make new investment in the old in order to provide advanced services.[85] Encouraging carriers to make such investments is supported by the clear language of Section 254.

(June 30, 2000) (Recommended Decision).

80 *Id.*

81 47 U.S.C. § 254(b)(1).

82 *Id.* § 254(b)(6).

83 *RTF Recommendation* at 29.

84 *Id.*

85 *See Puerto Rico Telephone Authority, Transferor, and GTE Holdings (Puerto Rico) LLC, Transferee, for Consent to Transfer Control of Licenses and Authorization Held by Puerto Rico Telephone Company and Celulares Telefonica, Inc.*, 14 FCC Rcd 3122 (1999).

Therefore, Vitelco urges the Joint Board to examine this issue further and consider developing a policy whereby a carrier is not precluded from obtaining higher levels of support simply by the circumstance of acquisition. Rather, the solution proposed by the RTF in this matter is one that eliminates the arbitrariness of the existing policy and rectifies the negative policy implications of that rule.

C. The Corporate Operations Expense Limitation Is an Arbitrary Cap on Universal Service Support.

The Joint Board must act to eliminate the corporate expense limitation currently restricting the ability of carriers to obtain universal service support based on all expenses necessary to the provision of supported service. The Commission adopted this policy prior to the full deliberation and consideration of the differences that insular and rural carriers face in providing services. Thus, it was not possible for the Commission to establish a cap that would "ensure that carriers use universal service support only to offer better service to their customers through prudent facility investment and maintenance"[86] without a full appreciation of this rural and insular difference. As a result, the continued presence of this cap, without reconsideration and review under the record currently developed, is arbitrary. Moreover, the waivers the Commission has granted with respect to this rule[87] illustrates that this limitation does inhibit the ability of rural and insular carriers to obtain the necessary support to provide universal service.

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86 *Universal Service Order*, 12 FCC Rcd at 8930.

87 *See Bristol Bay Telephone Cooperative, Inc.; Petition for Waiver of Section 36.621(a)(4) of the Commission's Rules*, 14 FCC Rcd 19671 (1999); *Arctic Slope Telephone Association Cooperative, Inc.; Petition for Expedited Waiver of Section 36.621(a)(4) of the Commission's Rules (Corporate Operations Expense Cap)*, 13 FCC Rcd 24217 (1998); *TelAlaska, Inc.; Petition for Expedited Waiver of Section 36.621(a)(4) of the Commission's Rules (Corporate Operations Expense Cap)*, 13 FCC Rcd 22729 (1998).

D. The Joint Board Must Permit Rural Carriers To Recover All Costs of Providing High Cost Service, Including Recovery of Stranded Costs.

In its recommendation to the Joint Board, the RTF merely recognized that the carrier that loses significant numbers of high cost line customers to a competitor might face a problem of unrecovered investment or "stranded costs."[88] These "stranded costs" represent legitimate investments in plant that exists because of regulatory policies that have limited the time period over which costs may be recovered (primarily through depreciation rates).[89] The ability of a carrier to recover these costs is an essential element of the regulatory pact that required carriers to serve all customers in exchange for the constitutionally mandated promise that carriers have the opportunity to earn a fair return on their assets. While competitive carriers contend that permitting recovery of such costs is somehow unfair, stranded costs represent real costs that regulators cannot "leave on the table." Therefore, Vitelco joins the RTF in recommending that the issue be raised to the FCC for further examination.

VIII. THE RURAL TASK FORCE RECOMMENDATION ENSURES THAT THE UNIVERSAL SERVICE MECHANISM IS CONSISTENT WITH COMPETITION BY MAKING IT AVAILABLE TO ELIGIBLE CARRIERS ON AN EQUITABLE BASIS.

Vitelco supports the RTF's recommendation to make universal service support for rural carriers available to all eligible telecommunications carriers ("ETC").[90] Under the RTF's proposal, once a competitive ETC ("CETC") begins providing service in a rural carrier's study area, the CETC would be entitled to the same per line universal service support as the incumbent

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88 *RTF Recommendation* at 39.

89 Rural Task Force, *Competition and Universal Service, White Paper No. 5*, at 19 (Sept. 2000), *at* http://www.wutc.wa.gov/rtf ("Competition White Paper").

90 *See RTF Recommendation* at 37.

carrier.[91] This portability mechanism establishes the competitive neutrality of the mechanism as required by the Commission's rules.

Vitelco urges the Joint Board to address how rural carriers will be able to recover their actual costs in the event that their universal service support revenues decline as CETCs increase their share of loops. Even as competition develops, rural carriers still need to recover their actual costs in order to maintain the sufficiency of support for service provided to its customers. Once a carrier loses enough customers, it may have trouble recovering its fixed costs from its remaining customers.

Therefore, Vitelco urges the Commission to adopt a safeguard to protect rural carriers in the event that the RTF's recommended portability mechanism fails to allow incumbent carriers to recover their costs.

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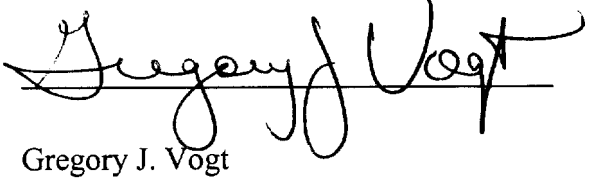
91 *See id.*

IX. CONCLUSION.

Vitelco is heartened by the work of the RTF. This package represents the consensus of a diverse group that attempted to accommodate wildly divergent interests. While the package is not perfect, Vitelco is not willing to let "perfection be the enemy of the good." The existing system is worse and application of the non-rural model is a disaster. Thus, for the above reasons, Vitelco urges the Joint Board to act quickly to recommend that the Commission adopt the package of proposals put forth by the RTF.

Respectfully submitted,

VIRGIN ISLANDS TELEPHONE CORPORATION

By: 

Samuel E. Ebbesen
President & Chief Executive Officer
Virgin Islands Telephone Corporation
P.O. Box 6100
St. Thomas, USVI 00801-6100
(340) 775-8617

Gregory J. Vogt
Daniel J. Smith
Derek A. Yeo
Wiley, Rein & Fielding
1776 K Street, NW
Washington, DC 20006
(202) 719-7000

Its Attorneys

November 3, 2000

APPENDIX A

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

IN THE MATTER OF	)	
	)	
FEDERAL-STATE JOINT BOARD ON	)	
UNIVERSAL SERVICE:	)	
PROMOTING DEPLOYMENT AND	)	**CC DOCKET NO. 96-45**
SUBSCRIBERSHIP IN UNSERVED AND	)	
UNDERSERVED AREAS, INCLUDING	)	
TRIBAL AND INSULAR AREAS	)	

COMMENTS OF

KENNETH GORDON, Ph.D.

ON BEHALF OF

THE VIRGIN ISLANDS TELEPHONE COMPANY

DECEMBER 17, 1999

n/e/r/a
Consulting Economists

COMMENTS OF
KENNETH GORDON, Ph.D.

CC DOCKET NO. 96-45

TABLE OF CONTENTS

COMMENTS OF KENNETH GORDON, PH.D.
DECEMBER 17, 1999

I. QUALIFICATIONS & INTRODUCTION

I am Senior Vice President of National Economic Research Associates, Inc. (NERA), where I specialize in utility regulation and related issues. I was Chairman of the Massachusetts Department of Public Utilities from January 1993 to October of 1995 and came to the Massachusetts Commission from the Maine Public Utilities Commission, where I also held the office of Chairman from 1988 through the end of 1992. Prior to that, I was an Industry Economist at the Federal Communications Commission's Office of Plans and Policies and earlier taught at several colleges since 1965, the most recent position having been at Smith College.

I was an active member of the National Association of Regulatory Utility Commissioners (NARUC) and served as president of that organization in 1992. I was also a member of the Executive Committee, and the Committee on Communications of NARUC. I served as Chairman of the New England Conference of Public Utilities Commissioners Telecommunications Committee, and am a former Chairman of the Power Planning Committee of the New England Governors' Conference. I have authored a number of publications and lecture widely on topics related to utility regulation. I am a graduate of Dartmouth College and

hold a doctorate in economics from the University of Chicago. A copy of my curriculum vitae is attached.

The purpose of my Comments is to demonstrate that the use of an unmodified national proxy cost model to determine the appropriate level of Federal universal service support for the U.S. Virgin Islands is likely to result in significant errors, and lead to adverse consequences for the telecommunications services consumers located there. The U.S. Virgin Islands have sufficiently unique economic, geographic and demographic characteristics that uncritical use of a national proxy cost model simply misses too many important drivers of both capital and operating costs, and likely results in levels of Federal funding that are too low relative to the underlying economic costs of providing service. The results are negative consequences in either the level of telecommunications deployment or subscribership. The harm could be significant and have non-trivial spillover effects because of the important role infrastructure development plays in the development process of small island economies. In my Comments, I:

- Analyze the unique economic and geographic conditions of small island economies (like the U.S. Virgin Islands) and identify how the Virgin Islands is different from the mainland locations upon which the FCC's proxy cost model is based;
- Discuss the importance of infrastructure development (such as telecommunications) to the growth of developing economies;
- Explain why the unique conditions of small island economies make it impossible to use a national proxy cost model to determine universal service costs. A national proxy cost model misses too many important factors;
- Discuss the likely negative consequences that will result if a national proxy cost model is used to determine universal service costs.